



US PREF

U.S. Partnership for  
Renewable Energy Finance

ITC Cash Grant

Market Observations

December  
2011

# Tax Equity and 1603 Treasury Grant Overview

- Renewable energy projects have historically been supported through the U.S. tax code, notably through:
  - The production tax credit (“PTC”) in Section 45,
  - The investment tax credit (“ITC”) in Sections 25D and 48, and
  - Accelerated tax depreciation in Section 168 (“MACRS”)
- Prior to the financial crisis, renewable energy developers had two options to monetize the favorable tax benefits granted through the tax code, either:
  - 1.) offset eligible U.S. taxable income from other business activities; or
  - 2.) Sell a portion of the project to an investor that has enough taxable income to monetize the PTC, ITC, and MACRS (“tax equity”; used by the majority of developers because they do not have other sources of taxable income)
- The financial crisis led to a dramatic contraction in the supply of tax equity, which subsequently crippled the market – this was largely driven by fewer counterparties that had less appetite to hold illiquid investments
  - As a result, Congress passed the Section 1603 Treasury Grant program in order to facilitate construction of renewable energy projects by monetizing the tax attributes (PTC, ITC) directly from Treasury
  - The Treasury Grant program enables qualifying renewable energy projects to utilize a cash grant of equal value to the ITC (“1603 Treasury Grant”) in lieu of needing to monetize the PTC or ITC in the tax equity market
  - However, developers still need to utilize either 1.) eligible corporate income, or 2.) tax equity to monetize the MACRS
- **Developers can only utilize Section 1603 Treasury Grants to monetize PTC and ITC through the end of 2011**

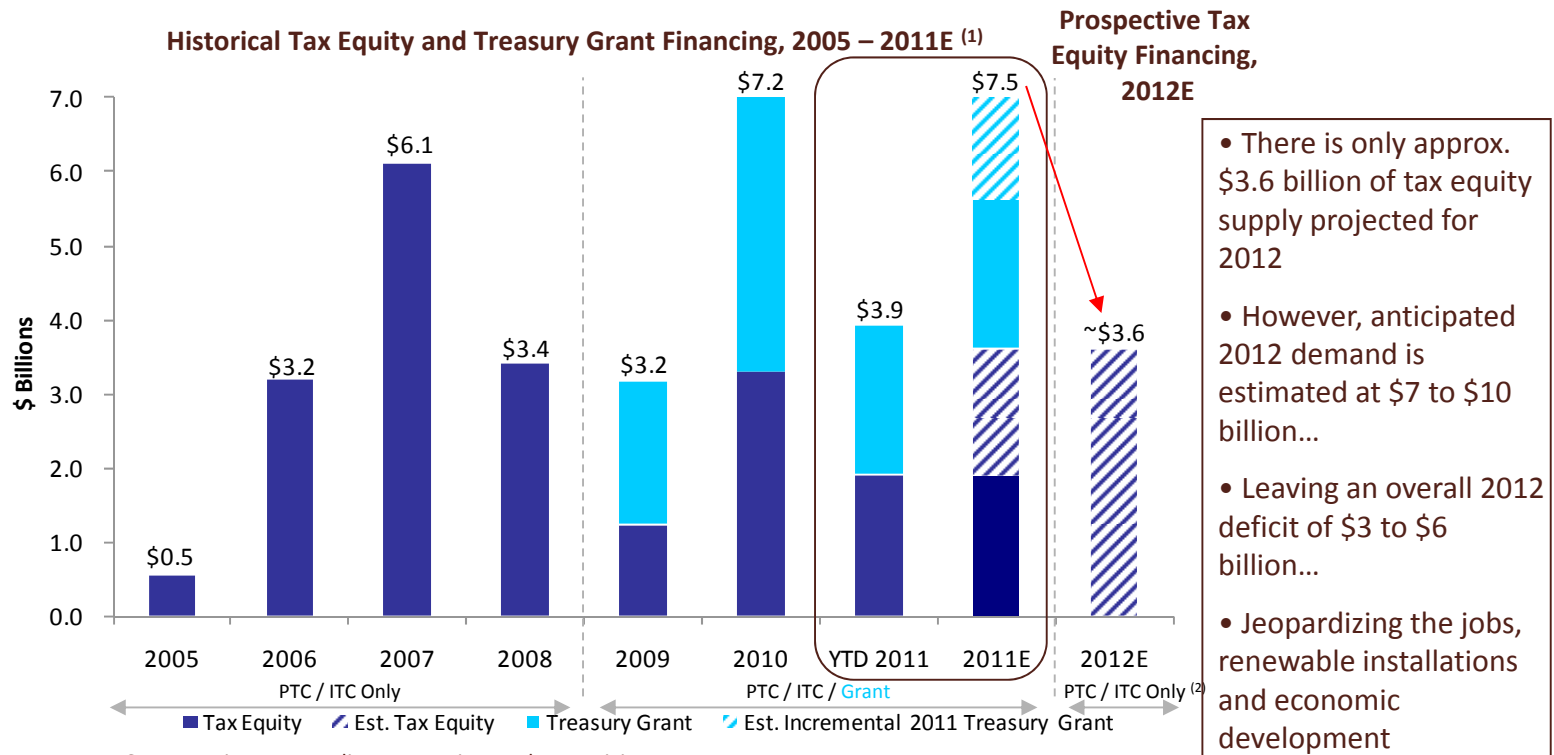
# Tax Equity and 1603 Treasury Grant Overview

- As can be seen on page 4, since 2009, the 1603 Treasury Grant program has filled the void left by the contracting tax equity market
  - The anticipated tax equity demand for 2012 ranges from \$7 to \$10 billion
  - However, the projected tax equity supply is only \$3.6 billion, leaving an approximately \$3 to \$6 billion deficit
  - Given the 1603 Treasury Grant program expires in 2011, it will not be available to satisfy this shortfall
- The 1603 Treasury Grant program has many virtues beyond filling the tax equity supply gap, which include:
  - 1.) Conveying 100% of the tax attribute to the renewable project: tax equity investors’ required return and fees consume approximately 30% of the tax attribute, leaving only 70% of the benefit to the renewable project
  - 2.) Projects that utilize the Grant can raise project finance debt that is less expensive and more abundant than tax equity. Without the grant program it is very difficult for a project that has tax equity investors to raise project-level debt.
  - 3.) Renewable projects that utilize the Grant are able to generate cash distributions to the holding company level, whereas a project that utilizes tax equity will see the majority of its cash flow swept by the tax equity investors at the project-level; the lack of distributable cash flow makes it impossible for renewable developers to pursue less expensive debt and equity offerings at their holding companies (REITs, MLPs, etc.); see page 5
  - 4.) The combination of a more efficient program of monetizing the tax attribute with the Grant coupled with less expensive holding company funding sources translates into lower cost power purchase agreements and more cash flow available for investment in project development, **ultimately leading to lower cost power for consumers, more renewable development and more jobs**
- The following chart depicts the cost of capital available to renewable developers and their projects with or without the Grant:

Renewable Financing	Grant Project	Tax Equity Project
<b>Project level</b>	Grant: 100% tax benefit Debt: approx. 6% rate	Tax equity: 70% tax benefit Tax equity: approx. 11-12% pre-tax rate
<b>Cash distributions to holding company</b>	Yes	No
<b>Holding Company</b>	Debt: approx. 10% rate Equity: approx. 10 to 15% rate	Debt: approx. 17% rate Equity: approx. 15 to 25% rate

# Success of the 1603 Treasury Grant

- In 2009, the Section 1603 Cash Grant program was introduced and stabilized the renewable energy market. **This was a successful Federal program**
- In 2010 and 2011, the 1603 Cash Grant program accelerated the penetration of the renewable energy as it continued to fill a void for renewable energy project finance in a market place with an overall shortage of tax equity that is projected to persist next year; **promoting job growth, installation of renewable MWs, and broader economic development**
- The tax equity market has recovered since the depths of the financial crisis in 2009, but the cash grant continues to play a crucial role in filling the void still persistent by an insufficient tax equity market



Sources: U.S. Department of The Treasury, US PREF Estimates, Leading Tax Equity Market Participants

(1) Includes all 1603 Treasury Grants for renewable projects

(2) Projects with 5% equity spend or in continuous construction prior to 12/31/2011 and that achieve COD by 12/31/2012 are eligible for the Section 1603 cash grant

# Innovative Capital Raising for Developers

- Section 1603 Cash Grant has **fostered a highly successful public / private partnership by allowing renewable developers to leverage the Cash Grant program to access new debt capital markets**, namely
  - the \$250+ billion high yield market, and
  - the \$150+ billion institutional loan market.
- **Access to these markets dramatically expands the pool of capital available to renewable developers**
- Prior to the Section 1603 Cash Grant, most renewable projects were financed with tax equity that swept the majority of the cash flows from the project. With the Section 1603 Cash Grant, renewable developers have been able to **utilize project-level debt that permits greater near-term cash distributions from projects to their developers**. These cash distributions have helped to facilitate access to the debt capital markets previously not available for renewable developers by allowing projects to service interest and principle at the developer parents, a financing across the developers entire project portfolio

## **Case Study 1: Independent Wind Developer's \$200 million Senior Secured Notes (High Yield) Offering**

- On May 17, 2011, an independent wind developer issued \$200 million of 10.250% Senior Secured Notes due June 2018
- The developer is an independent pure play wind energy company focused on high return contracted / hedged projects in the Northeast, West and Hawaii and currently has 13 projects operating / under construction totaling 771 MW and a 4,000 MW development pipeline
- Net proceeds from the offering are being used to provide liquidity to fund five Near Term projects (350+ MW) and for other corporate purposes
- **The 1603 Cash Grant made this financing possible**

## **Case Study 2: Independent Wind Developer's \$200 million Senior Secured (Institutional) Term Loan Offering**

- On November 22, 2011, an independent wind developer closed a \$200 million Senior Secured Term Loan priced at approximately 9.5% and due November 2017
- The developer is an independent wind energy company that recapitalized 25 operating / under construction projects totaling 2,695 MWs across the United States, Canada and Poland
- Net proceeds from the offering are being utilized to provide liquidity to fund future project development and recapitalize existing debt
- **The 1603 Cash Grant helped facilitate this financing**